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TAGS: CH ECON EFIN PGOV PREL
SUBJECT: CHINESE BANKS: WILL THE 2009 CREDIT BINGE COME
BACK TO HAUNT?

REF: BEIJING 292

Classified By: Economic Minister Counselor William Weinstein; reasons 1
.4 (b, d)

¶1. (C) Summary. New loan issuance by Chinese banks in January totaled RMB 1.6 trillion (USD 235 billion), nearly equal to last year's record pace of RMB 1.62 trillion, and would have been even larger if regulators had not intervened mid-month to curtail lending. In public, Chinese financial officials remain confident that the 2009 credit surge will not lead to a resurgence of non-performing loans (NPLs) that could undermine the banking sector. On February 2, however, Fitch Ratings downgraded its assessments of China Merchants Bank and China CITIC Bank due to capital depletion and rising credit risk. Fitch also remains concerned about the accuracy of China's banking data. The IMF Beijing office, while not disputing Fitch's assessment, believes there is no systemic risk in sight, and that the Chinese Government has the resources and will to address any NPL problem that might arise. End Summary.

¶2. (C) Comment. We agree with both Fitch -- about future NPL problems in some Chinese banks -- and the IMF -- that the Government is ready and willing to address quickly and firmly any bank problems that might emerge. Chinese banking regulators are proud of the progress they and their banks have made over the past decade, and will do everything within their power to prevent a return to the "bad old days" of massive NPLs. However, if the government is forced sometime in the next five years to expend significant resources for bailing out banks, then the negative consequences could be considerable: damaged public and investor confidence in the banks, the regulators, and the government; rising fiscal deficits; slower economic growth for China and its trading partners; and reduction of funds available for expansion of much-needed social welfare programs that promote domestic consumption and economic rebalancing. End Comment.

The Surge Continues

¶3. (SBU) On February 1, Chinese official media reported that new loan issuance by Chinese banks in January totaled RMB 1.6 trillion (USD 235 billion), nearly equal to last year's record pace of RMB 1.62 trillion. That number, however, could have been even larger had not authorities slowed the pace of lending sharply in the last ten days of January. As of January 19, banks already had extended loans totaling RMB 1.45 trillion, but then were pressured by regulators to slow the pace and even to recall some loans already extended. Several large banks reportedly stopped new loan issuance

during the last few days of January, and the China Banking Regulatory Commission (CBRC) instructed a few of the biggest lenders to increase their required capital reserve ratios. (Note: China's official "target" for 2010 lending is RMB 7.5 trillion, down from RMB 9.6 trillion last year, although officials describe that number as a "ballpark goal" or even a "floor" for lending. End note.)

¶4. (SBU) In public, Chinese financial officials including CBRC Chairman Liu Mingkang remain confident that the 2009 credit surge, now extending into 2010, will not lead to a resurgence of non-performing loans (NPLs) that could undermine the banking sector. They note that the overall NPL rate has fallen precipitously, from as high as 50 percent in the mid-1990s and 17.9 percent in 2003, to just 1.58 percent at the end of last year. Most outside observers concede that the position of Chinese banks has improved enormously over the past ten years.

Problems on the Horizon

¶5. (C) On February 2, however, Fitch Ratings downgraded its assessments of China Merchants Bank and China CITIC Bank from "C/D" to "D", bringing those banks' ratings into line with other Chinese banks. Fitch cited the two banks' capital depletion and "rising on- and off-balance-sheet credit risk in the wake of last year's very rapid loan growth." It also reported that Chinese banks in general appear to be carrying additional, hidden credit risk from unreported loan sales: China Merchants and China CITIC specifically have been most active in packaging loans into "wealth management" products

for sale to investors. According to Fitch, purchasers of these products sometimes receive little or no information about the quality of the actual loans.

¶6. (C) Fitch's Beijing representative on February 3 told us her credit rating agency was very concerned about the continuing flow of new lending by many Chinese banks, and also was not entirely convinced that China's published NPL numbers are accurate. She described a non-transparent "lending culture" in the banks that encourages loan officers to lend but discourages them from truthfully reporting loan failures. The Fitch representative said Chinese banks over the past year have issued large volumes of "bullet loans," for which the borrower pays only interest for several years until the principal comes due, at which time the lenders often "roll over" the loan to avoid having to list it as non-performing. Finally, she cited anecdotal evidence in the form of numerous vacant and/or unfinished real estate development projects in every major Chinese city as indicative of a larger potential NPL problem.

IMF: No Systemic Risk

¶7. (C) IMF resident representative Tarhan Feyzioglu told us on February 4 that, although he did not dispute Fitch's description of the problems within individual banks, he was less concerned about a resurgence of NPLs. He said the IMF's view was that NPLs might be a medium term problem (i.e., 2-5 years), but both the short-term and long-term outlooks for the banking system as well as the overall economy were healthy. Even if the aggregate NPL rate increased significantly, and/or some individual banks encountered serious problems, he did not see any real systemic risk on the horizon. Also, with some USD 2.4 trillion in foreign exchange reserves and a generally healthy fiscal situation, Feyzioglu believed the central government had more than sufficient resources available to clean up any NPL problem that might arise.
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